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Dear David,

### **ITC 14: Proposed Definition and Guidance for Not-For-Profit Entities**

We are pleased to provide our views on the proposed guidance and definition of not-for-profit (NFP) entities in Australia. These views in part reflect the outcomes from the research we conducted as part of a report prepared for CPA Australia and also the discussions at the Roundtable held in Melbourne on March 11, attended by two of the authors.

Our research provides very strong support for the definition of a NFP entity to include a criterion that the entity may not distribute surpluses in any manner including at dissolution. Indeed respondents in both the public and private sectors considered this an essential characteristic. This requirement was included in the proposed definition that was submitted to the board on 1 May 2007 by CPA Australia.

We understand that there was some concern expressed that if an entity reduced membership fees in any year this may be interpreted as a return of surpluses from previous years. Indeed this very issue was raised at the Roundtable on March 11 and the response from all participants on the day was that this would normally not constitute a return of surplus but merely reflect situations such as where fund raising exceeded expectations in the preceding year or projected expenses were lower than expected. If an entity was pursuing such a strategy that in substance was clearly aimed at returning surpluses and circumventing the definition then it would clearly fail the proposed definition. Professional judgement will always apply irrespective of the final definition adopted by the Board. This is particularly evident from the scenarios included in ITC 14.

Based on the feedback at the March 11 Roundtable we now offer the following revised definition:

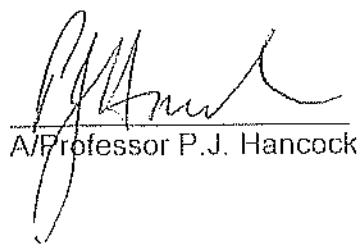
" An entity shall be classified as not for profit (or community benefit) when that entity may not return surpluses to members or owners either while it is active or at dissolution. The entity also has operating purposes other than or in addition to the provision of goods and services at a profit."

Based on this definition, entities in both the public and private sector which have the ability to distribute surpluses to members or owners are for-profit, irrespective of the status of those members or owners. For example, a public sector entity that is required to generate a specified return and pay the resultant dividend to government is not a NFP entity. That does not make the group (or the government owner) for-profit. The same scenario would apply in the private sector where an entity distributes profits from activities to the parent who may be a charity or other form of NFP entity. The status of the owner or member does not determine the status of the entity and it is possible (and in cases of large organisations such as churches or religious organisations) that a group includes both FP and NFP entities. As a result, group financial reporting would be on a NFP basis where the parent clearly meets the definition of a NFP entity.

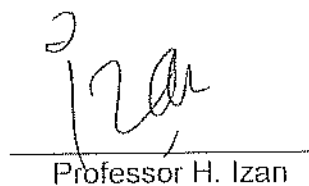
Our answers to the specific questions included in ITC 14 are:

- 1) We support the use of one definition for both the public and private sectors with additional guidance used to capture any specific differences like the distribution of a dividend by a public sector entity to government.
- 2) We believe the term that is used is much less important than the definition. However, the comments at the March 11 Roundtable reflect a view from the sector that the perception of the sector would be more positive if it were described as public or community benefit entity. While the use of the term public benefit would converge us with New Zealand, it would create divergence with many other jurisdictions which use the term not-for-profit.
- 3) Our comments on the definition are reflected in our opening comments.
- 4) We support the use of guidance which will be helpful for those applying the definition to entities that do not clearly present as NFP- irrespective of which definition is adopted.
- 5) We believe it is important that entities be required to disclose if they are NFP or for-profit given the different financial reporting requirements that apply to each sector.


Yours sincerely,



Professor P.J. Hancock



Professor H. Izan



Lydia Kilcullen